



global weekly

Investment
Communication
6 May 2016**Lurking political risks**

Downbeat economic data, including weakness in US manufacturing, pushed equity markets lower this week. A weaker US dollar and easing financial conditions, however, should support the recovery of the US economy in the coming quarters.

Over the next few months, political risks in Europe are expected to rise. As the Brexit referendum (23 June) nears, the prospect of the UK leaving the EU starts to dominate headlines. Recent polls showed that the odds of the UK remaining in the EU have increased. Betting markets are moving in the same direction, with bookmakers increasingly betting on British voters saying 'no' to a Brexit. Our base case scenario is that the UK will remain in the EU.

Equity markets update

Markets were volatile this week. Europe and Asia lagged compared to other regions. US markets also declined, but this was somewhat offset as the US dollar depreciated relative to other currencies. A shift to more defensive sectors has occurred. Utilities, as well as the consumer discretionary and consumer staples sectors, rose. As the rally in commodities stalled, the energy and materials sectors declined.

The US earnings season is nearing its end, with two-thirds of the companies having already reported their first-quarter numbers. Overall, earnings are slightly ahead of expectations, but revenues are lagging. Company outlooks consist mostly of a reiteration of previous statements. In the short term, these results are not a trigger for the markets to continue to rally. In Europe, the trend is similar. European companies, however, are also faced with a strengthening euro and the threat of Britain leaving the European Union.

Asian indices fell, as the Bank of Japan did not announce additional monetary stimulus. In reaction, the Japanese yen strengthened substantially. China manufacturing data was also disappointing.

After two months of rising stock prices, markets lost ground this week. Profit-taking could trigger a further decline.

Equity index performance in local currency

	Value	One week change (%)	Year-to-date (%)
MSCI ACWI	395.4	-2.0%	-1.0%
S&P 500	2050.6	-0.7%	0.3%
AEX Index	429.6	-2.3%	-2.8%
EuroStoxx 50	2932.6	-3.2%	-10.8%
DAX Index	9839.0	-2.0%	-8.8%
Nikkei 225	16106.7	-3.4%	-16.7%
Hang Seng Index	20136.6	-4.5%	-8.5%

Important rating changes (RL=Recommended List; NR=not rated)

Company	From	To
Valero	Hold	Buy
Royal Caribbean Cruises	Hold	Buy
Halliburton	Hold	Sell
Avon Products	Hold	Buy
Societe Generale	Hold	Buy

Government bond yields

	Yield (%)	One week (bp)	One year (bp)
US Treasuries 2-year	0.728	-5.6	9.1
German Bunds 2-year	-0.513	-2.8	-29.0
Japan 2-year	-0.253	-1.2	-25.4
US Treasuries 10-year	1.745	-9.0	-49.9
German Bunds 10-year	0.152	-11.8	-43.3
Japan 10-year	-0.122	-3.9	-47.9

Spreads

Index	Spread (bp)	One week (bp)	One year (bp)
CDX NA IG	84.74	6.20	19.68
iTraxx Euro 5-year	79.55	6.00	16.46
JPM EMBI+	399.34	18.89	31.07

Performance data as of Friday 6 May

Source: Bloomberg

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Profit-taking was a factor in our decision to reduce equity exposure in mid-April.

Reporting calendar

Company	Date
Enel Green Power S.P.A., PostNL, Teva Pharmaceutical Industries, ENEL Ente Nazionale Per L'Energia Elettrica	09 May
Crédit Suisse, Electronic Arts, Walt Disney, Allergan, ThyssenKrupp, Symrise, Adecco, Munich Re, Easyjet, ING	10 May
Petrobras, Petrobras, Vivendi, E.ON, CTrip.Com Int., LANXESS, Alstom, Metro, Carlsberg	11 May
Noble Group, Crédit Agricole, Aegon, RWE	12 May
Bouygues, Klépierre	13 May

Bond markets update

Markets this week were influenced by a falling oil price and increasing currency market volatility. Key rates moved sharply, with intraday ranges for the euro, Japanese yen and pound sterling shifting in the range of 1-1.5%. Both the yen and the euro are strengthening versus the US dollar and have surpassed the high points seen in 2015. As a result, US and European rates fell. German 10-year Bund yields dropped from 30 to below 20 basis points.

As equity prices retreated this week, credit risks increased. Corporate bonds, however, are heavily supported by the intent of the European Central Bank to incorporate them into the central bank's bond buying programme. Peripheral bond risks are increasing, as events impacting peripheral markets approach.

June will be an eventful month for fixed income markets. In addition to the Brexit referendum, there may be Spanish elections at the end of the month. June is also around the time when the ECB is expected to start buying corporate bonds. The meeting of the Federal Reserve in the middle of June may be significant as well, as US central bank policymakers are becoming more vocal about the prospect of rate hikes, although we do not expect a hike this year. The Bank of Japan and the Bank of England also meet the day after the Fed's meeting.

Currency outlook

Since 25 April 2016, the EUR/USD has rallied by more than 3% to a high on 3 May of just above 1.16. This rally has mainly been fuelled by a weaker US dollar, following weaker-than-expected US economic data and a downward adjustment in Fed rate-hike expectations. The EUR/USD may rally towards 1.20 if US economic data continues to be weaker than expected.

Overall, we expect EUR/USD to be range-bound for the foreseeable future at around 1.15, within a 1.10-1.20 range. The multi-year bull trend of the US dollar has come to an end. So if the range in EUR/USD is broken, it will likely be on the side of dollar weakness.

Asset allocation

The Global Investment Committee, at its meeting on Wednesday 4 May 2016, decided to leave the asset allocation unchanged. The asset allocation continues to call for a moderate overweight in equities and an underweight in bonds. Commodities are overweight, with neutral allocations to both real estate and hedge funds. The committee decided to put a stop loss on its GBP currency hedge for USD-based portfolios.

Published this week

Bond Markets Monthly: Sentiment Is Vulnerable

Bond investors ended the first quarter in an upbeat mood. Strong price swings, however, indicated that markets are fragile. We expect market sentiment to remain vulnerable.

Investment Strategy & Portfolio Expertise

Group Economics



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